

Message Text

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ACTION EB-07

INFO OCT-01 EA-06 ISO-00 AID-05 CIAE-00 COME-00 FRB-03

INR-07 NSAE-00 TRSE-00 XMB-02 OPIC-03 SP-02 CIEP-01

LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-01 CEA-01 EUR-12

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FM AMEMBASSY TOKYO

TO SECSTATE WASHDC 8335

C O N F I D E N T I A L SECTION 1 OF 2 TOKYO 2642

PASS TREASURY AND FEDERAL RESERVE

E.O. 11652: GDS

TAGS: EFIN, JA

SUBJ: MOF VIEW OF RECENT FOREX DEVELOPMENTS

1. SUMMARY: MOF IS QUITE RELAXED ABOUT RECENT STRENGTHENING OF YEN (CONSIDERED TO BE ONLY TEMPORARY) AND SEES NO NEED FOR CHANGES IN FOREX CONTROLS AT THIS TIME. FOLLOWING ARE COMMENTS ABOUT JAPAN'S B/P PROSPECTS AND RECENT FOREX MARKET DEVELOPMENTS BASED ON FINATT CONVERSATION WITH DEP DIR, INTFIN BUR, MATSUNAGA, WHO WILL ACCOMPANY VICEMIN YOSHIDA TO FORTHCOMING OECD-WP 3 MEETING. END OF SUMMARY.

2. JAPAN'S B/P PROSPECTS: OFFICIAL GOJ FORECAST (TOKYO 460 NOTAL) FOR JFY 75 IS DEFICIT OF \$1.7 BIL ON CURRENT ACCOUNT (\$2.5 BIL IN JFY 74) AND DEFICIT OF \$3.9 BIL ON BASIC BALANCE (\$5.5 BIL). STRONG TRADE PERFORMANCE IN RECENT MONTHS (EVEN CURRENT ACCOUNT SURPLUSES ON S.A. BASIS) IS EXPECTED TO DETERIORATE LATER THIS YEAR. THIS DUE TO SLOW GROWTH IN EXPORT MARKETS, A PROSPECT CONFIRMED BY LATEST OECD FORECAST (OECD PARIS 3914). IN FACT, SAID MATSUNAGA, MOST RECENT OECD FORECAST FOR JAPAN
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OF \$2 BIL DEFICIT ON CURRENT ACCOUNT IN CY 75 IS CLOSE

TO OFFICIAL GOJ FORECAST AND REPRESENTS A SUBSTANTIAL REVISION OF PREVIOUS OECD FORECAST OF ONLY \$0.75 BIL DEFICIT. THUS WITH OUTLOOK FOR B/P DEFICIT, MOF CONSIDERS RECENT STRENGTH OF YEN IN FOREX MARKET TO BE DUE TO TRANSITORY FACTORS.

3. RECENT FOREX MARKET DEVELOPMENTS: YEN TRADED AT ALMOST 300/DOL LEVEL DURING MOST OF NOV AND DEC BUT BEGAN STRENGTHENING AGAINST DOL, ALONG WITH EUROPEAN CURRENCIES, IN LATE JAN. YEN HAS SUBSEQUENTLY APPRECIATED, BREAKING THROUGH 290/COL LEVEL ON JAN 21. DURING THIS PAST WEEK TRADING HAS BEEN LAREGLY AT ALMOST 285 LEVEL. HOWEVER, UNLIKE PREVIOUS PERIODS YEN TRADING IN LONDON AND NEW YORK HAS COME TO INFLUENCE OPENING TRADING IN TOKYO THE FOLLOWING DAY. AS YEN ROSE ABROAD OPENING TRADING IN TOKYO ALSO ROSE ABOVE PREVIOUS DAY CLOSE. MATSUNAGA SAID GOJ HAS INTERVENED ON OCCASION TO SUPPORT DOL WITH THE OBJECTIVE OF MAINTAINING ORDERLY MARKET CONDITIONS. THERE HAS BEEN NO GOJ ATTEMPT, UNDER THE GUIDELINES FOR FLOATING, TO SET A NEW LEVEL FOR THE YEN. DESPITE (LIMITED) INTERVENTION THERE HAVE BEEN SHARP RATE MOVEMETS. ON FOUR TRADING DAYS IN FEB DROP IN CENTRAL RATE OF DOL HAS BEEN AS MUCH AS 2 YEN PER DOL OR MORE.

4. CAPITAL MOVEMENT: MATSUNAGA SAW LITTLE EVIDENCE OF SPECULATIVE DEMAND FOR YEN SINCE FREE YEN DEPOSITS OF FOREIGNERS ARE LITTLE CHANGED. FOLLOWING ARE OTHER POSSIBLE INFLUENCES ON RECENT FOREX MARKET ACTIVITY:

(A) FOREIGN PURCHASES OF JAPANESE STOCKS AND BONDS: IN PAST MONTH THESE PURCHASES HAVE ACCELERATED, AMOUNTING TO PERHAPS \$200 MIL IN FEB AS AGAINST \$63 MIL IN JAN. DEMAND FOR JAPANESE EQUITIES MAY BE RELATED TO RECENT REVIVAL OF TOKYO STOCK MARKET BUT THERE ARE RUMORS OF SUBSTANTIAL ARAB OIL COUNTRY DEMAND FOR GOOD QUALITY JAPANESE STOCKS. MATSUNAGA DID NOT BELIEVE DEMAND FOR BONDS REFLECTED ARBITRAGE INCENTIVES (I.E. RELATIVELY HIGH INTEREST RATES IN JAPAN). MOF HAD NO CLEAR IDEA WHO WAS PURCHASING JAPANESE BONDS. SECONDARY MARKET IS THIN SO THAT SUPPLY IS RATHER SMALL. MATSUNAGA BELIEVED BOND

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DEMAND BY FOREIGN SHIP BUYERS (TO HEDGE THEIR YEN DEBTS) WAS PROBABLY LIMITED. IMPLICATION WAS THAT OIL PRODUCING COUNTRIES MAY WELL BE LARGEST BUYERS.

(B) LEADS/LAGS: MOF SEES LITTLE EVIDENCE THAT SPECULATIVE LEADS/LAGS HAVE INFLUENCED YEN RATE IN RECENT WEEKS. SUCH SPEUCLATION IS LIMITED UNDER FOREX REGS, ALTHOUGH WITH MONTHLY TRADE NOW TOTALING AROUND \$10 BIL

EVEN SMALL SHIFTS IN LEADS/LAGS COULD HAVE SIGNIFICANT
INFLUENCE ON FOREX DEMAND.

(C) IMPACT LOANS: IN FIRST QUARTER VOLUME OF IMPACT
LOANS WAS INCREASED. BOJ ALLOCATES MONTHLY AMOUNT AMONG
JAPANESE BANKS WHO THEN HAVE QUOTA ON GUARANTEES THEY
CAN PROVIDE ON NEW IMPACT LOANS TO BE ARRANGED FOR FAVOR-
ITE CUSTOMERS WITH FOREIGN BANKS. BOJ ALSO ALLOCATES
SOME IMPACT LOANS DIRECTLY TO JAPANESE COMPANIES WHO
MAY THEN BORROW DOLS FROM FOREIGN BANKS WITHOUT BANK
GUARANTEE. TOTAL VOLUME IS THUS TIGHTLY REGULATED BUT
AMOUNT IS NOT DISCLOSED. U.S. BANKERS REPORT SOME BOJ
DELAY IN APPROVING NEW IMPACT LOANS BUT THIS MAY BE TEM-
PORARY AND PROBABLY NOT RELATED TO CURRENT YEN STRENGTH.
WITH TIGHT MONEY AND HIGH DOMESTIC INTEREST RATES IMPACT
LOANS HAVE BEEN IN HIGH DEMAND. THEY ARE GENERALLY FOR 5
YEARS AT RATE USUALLY EQUIVALENT TO 1 PERCENT ABOVE LIBO.
IN VIEW OF CURRENT LOAN DEMAND, SOME BANKERS HAVE BEEN
ABLE TO CHARGE UP TO 2 PERCENT ABOVE LIBO SO THAT A
"JAPAN RATE" HAS DEVELOPED ON IMPACT LOANS. IF FOREIGN
BANKS OBTAIN COMPENSATING YEN BALNCES, THEY CAN EARN
AROUND 14-3/4 PERCENT IN LOCAL CALL MONEY MARKET. APPAR-
ENTLY BOJ IS SEEKING TO ELIMINATE "JAPAN RATE" THROUGH
WITHHOLDING APPROVAL OF SOME IMPACT LOANS.

(D) BANKING FUNDS: JAPANESE BANKS CONTINUE TO BORROW
DOLS ABROAD BUT USE OF PROCEEDS IS STRICTLY REGULATED
AND DOES NOT REPRESENT A SOURCE OF "OUT-IN" FINANCING
LIKE IMPACT LOANS. MOF OFFICIAL ADMITTED JAPANESE BANKS
SEEKING DOL DEPOSITS DIRECTLY FROM OIL COUNTRIES BUT
WAS VAGUE REGARDING AMOUNT, SAYING THAT PRIMARY SOURCE
IS STILL FROM U.S. AND EUROPEAN MARKETS. FOREIGN BANKS
HAVE NOT BEEN PERMITTED TO INCREASE THEIR SWAP LINES
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(FOREIGN FUNDS CONVERTED INTO YEN BUT WITH FORWARD COVER)
SINCE MID 74.

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ACTION EB-07

INFO OCT-01 EA-06 ISO-00 AID-05 CIAE-00 COME-00 FRB-03

INR-07 NSAE-00 TRSE-00 XMB-02 OPIC-03 SP-02 CIEP-01

LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-01 CEA-01 SEC-01

NEA-09 L-02 H-01 /078 W

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R 280811Z FEB 75

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC 8336

C O N F I D E N T I A L SECTION 2 OF 2 TOKYO 2642

PASS TREASURY AND FEDERAL RESERVE

(E) NEW SECURITY ISSUES: "OUT-IN" BOND FINANCING IN U.S. AND EUROPE BY JAPANESE COMPANIES IS NOW UNDER WAY (SEE TOKYO A-49). MOF BELIEVES JAPAN NEEDS TO BORROW FUNDS ABROAD AT LONG TERM IN VIEW OF THE PROSPECTIVE B/P DEFICIT AND THE VERY HEAVY RESORT TO SHORT-TERM BANK BORROWING ABROAD IN 74. AS IN THE PAST YEAR, JAPAN WILL CONTINUE TO PROHIBIT DOMESTIC FLOTATION OF FOREIGN ISSUES (DESPITE PRESS REPORTS TO THE CONTRARY) ON GROUNDS OF B/P NEED AND DOMESTIC FINANCING REQUIREMENTS THROUGH THE CAPITAL MARKET. (COMMENT: THIS SUGGESTS THAT OFFICIALS VIEW INTERNATIONAL CAPITAL ISSUES PURELY IN TERMS OF DOMESTIC REQUIREMENTS AND HAVE NO INTEREST IN MAKING JAPAN INTO AN INTERNATIONAL FINANCIAL CENTER IN THE NEAR FUTURE.)

5. DURING WEEK OF FEB 17-21, DOL HELD STEADY ON TOKYO FOREX MARKET. DURING FIRST THREE DAYS, EASED A BIT THURS, 20TH, AMID CALM TRADING, THEN DROPPED BELOW 290 LEVEL ON FEB 21 WITH SPOT VOLUME SOARING ABOVE \$185 MIL. OFFICIAL CONFIDED THAT BOJ SUPPLIED SLIGHTLY MORE THAN HALF OF DOL QUANTITY DEMANDED THAT DAY. WHEN MARKET OPENED FOLLOWING MON, FEB 24, DOL AGAIN FELL AMID HEAVY TRADING AND
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BOJ AGAIN INTERVENED. ON FOLLOWING DAY BANK INTERVENTION WAS MODEST AS DOL FIRMED AFTER INITIAL DECLINE TO YEN 285/DOL. TTOAL BOJ SUPPORT FEB 24-25 WAS ABOUT \$100 MIL ACCORDING TO CONFIDENTIAL BOJ SOURCE. DOL HAS FIRMED SLIGHTLY DURING LAST THREE DAYS AND MARKET APPEARS TO BE CORRECTING ITSELF AFTER RELATIVELY SWIFT DECLINE OF DOL. BOJ SOURCE BELIEVES DOL MAY NOW BE IN FOR TECHNICAL

CORRECTION AND STRENGTHEN SLIGHTLY.

6. FOLLOWING ARE DATA FOR SPOT AND FORWARD DOLLAR RATES
AND VOLUMES DURING PAST TWO WEEKS:

	CENTRAL SPOT RATE (YEN/DOL)	FORWARD DOLLARS (PREMIA IN PCT. P.A.) 3-MO	6-MO	SPOT VOL (MIL DOL)
FEB 17	293.50	0.55	.051	81
18	293.50	0.61	0.41	89
19	293.50	0.20	0.24	81
20	291.65	0.34	0.41	91
21	289.50	2.49	0.62	186

WEEKLY FWD VOLUME WAS \$409 MIL AND SWAP VOLUME \$351 MIL

FEB 24	287.00	0.84	0.63	168
25	285.00	1.22	0.63	108
26	285.50	0.98	0.70	87
27	285.20	2.31	0.91	109
28	286.60	0.70	0.45	110

WEEKLY FWD VOLUME WAS \$548 MIL AND SWAP VOLUME \$96 MIL.
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